



DG ECFIN

# **The spread of the crisis**

## ***Effect of the crisis on public finances***

### **European Parliament 14<sup>th</sup> January 2010**

**Marco Buti**

**Director-General**

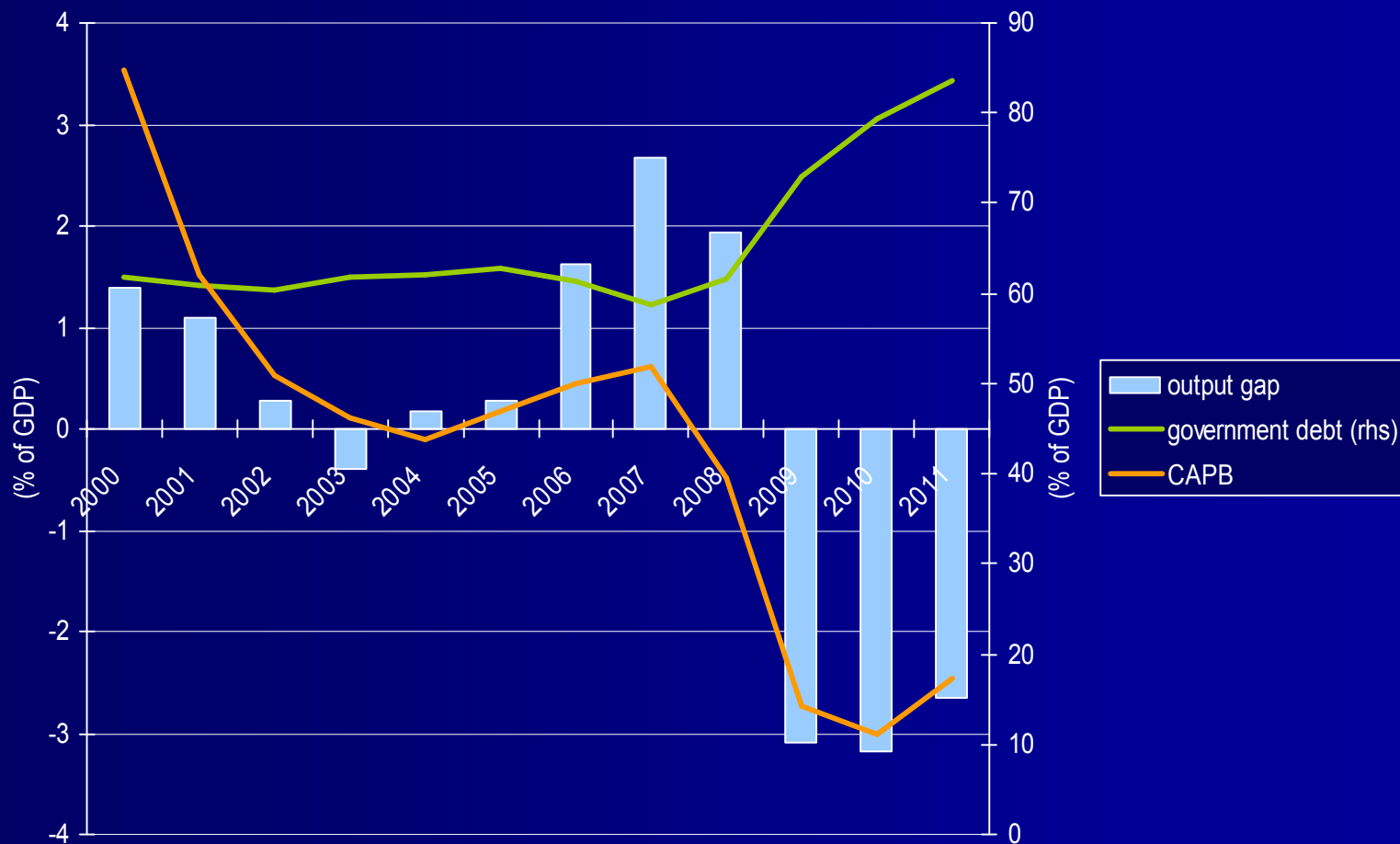
**DG Economic and Financial Affairs**

**European Commission**



# Short-term – expansionary fiscal policy to respond to the crisis

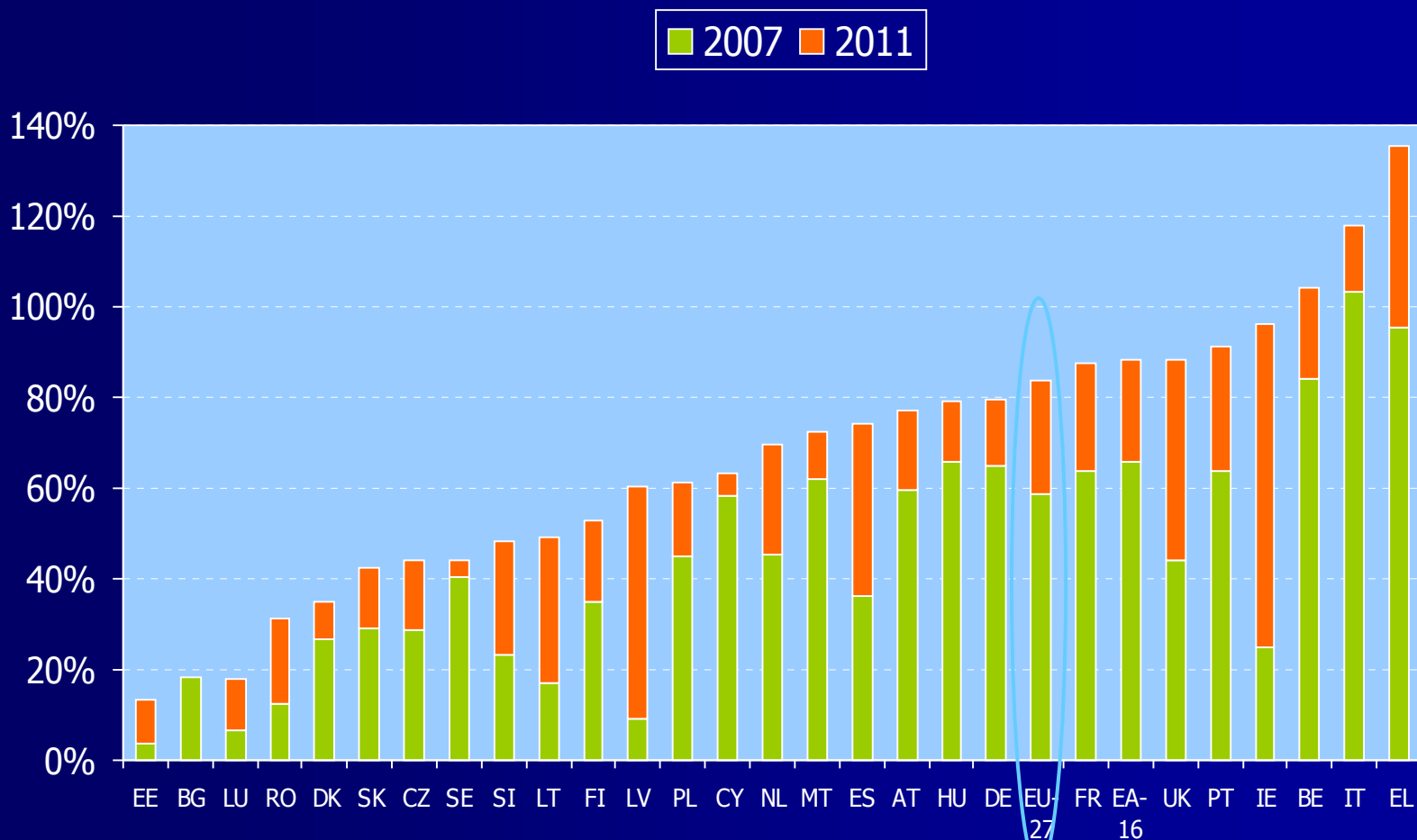
## The public finance situation in the EU





# Impact of the crisis on government debt

## Change in government gross debt as a share of GDP – Commission Autumn 2009 forecasts



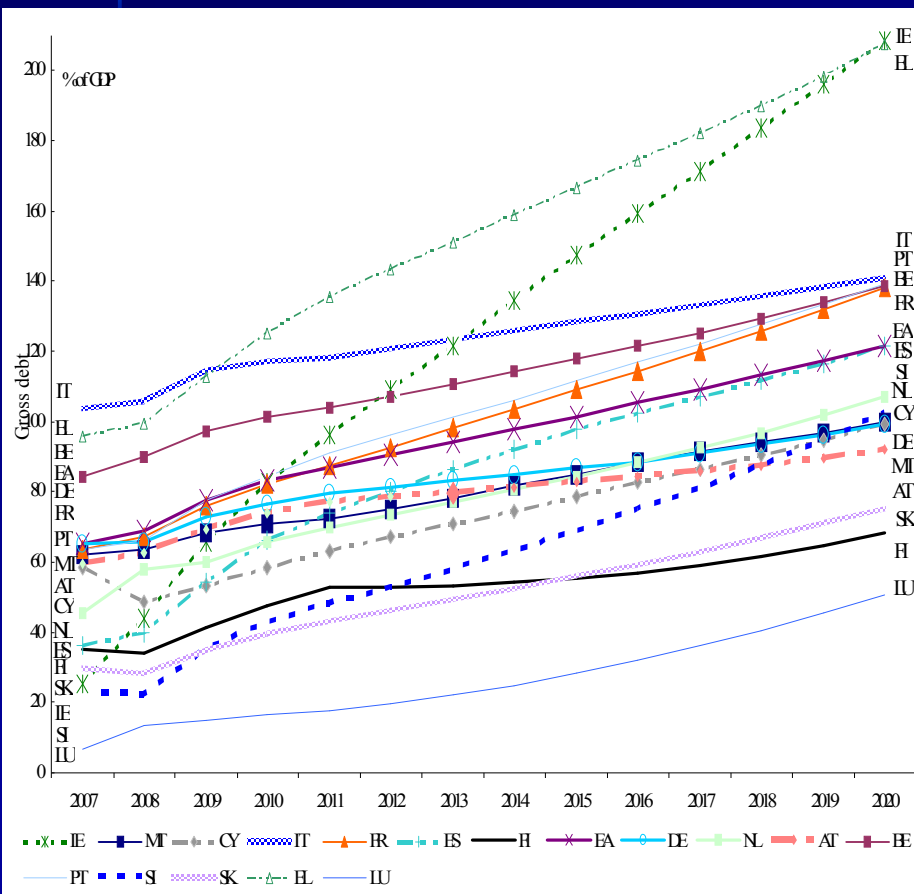


# The medium term: government debt

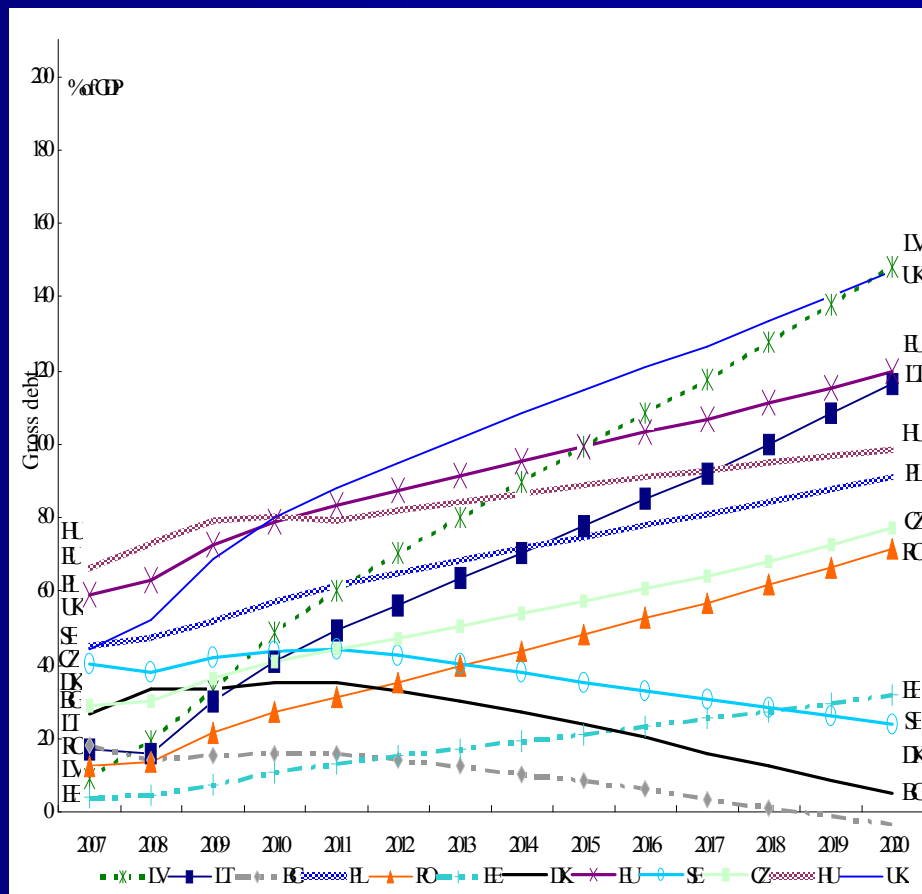
Debt is on-track to reach 120% of GDP by 2020 in the absence of consolidation

Ageing is a concern that adds to sustainability worries

### Euro area



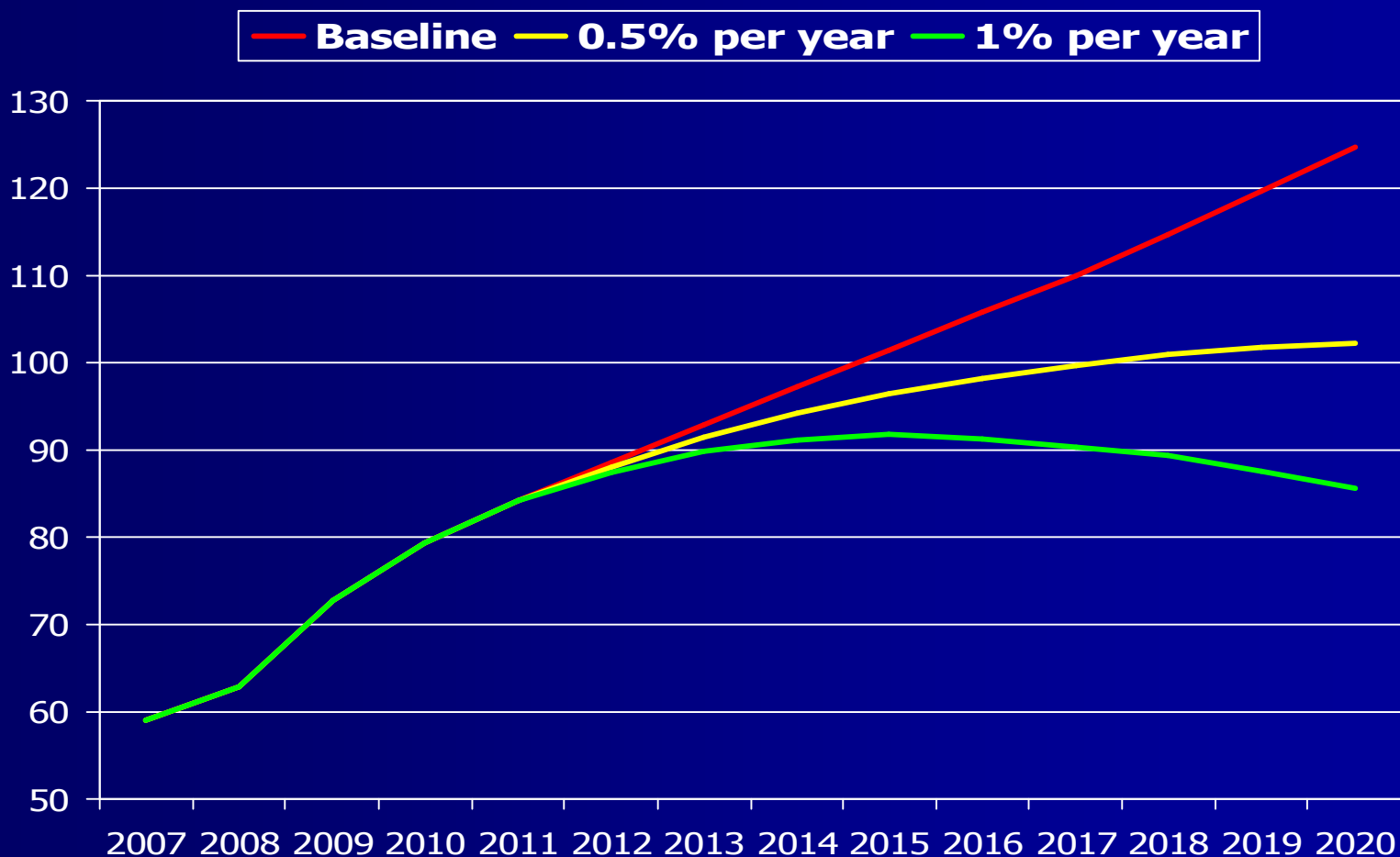
### Non-euro area





## Exiting from the fiscal stimulus

### Trajectory of debt as a share of GDP based on different levels of consolidation





## Exit – fiscal policy

### ECOFIN Council 20 October 2009 and European Council 29-30 October Coordinating fiscal exit strategies

- ✓ Fiscal consolidation should be coordinated within a consistent implementation of the SGP.
- ✓ Withdrawal of stimulus should be timely and differentiated. Consolidation should start in 2011 at the latest, with some countries needing to consolidate earlier, and will need to go well beyond the benchmark 0.5% of GDP per annum.
- ✓ Pace of consolidation conditional on a self-sustaining recovery
- ✓ Important additions:
  - Strengthened national budgetary frameworks to underpin credibility of consolidation.
  - Measures to support long-term fiscal sustainability
  - Strengthening of structural efforts to enhance productivity and support long term investment

# EU fiscal surveillance – Coordinating fiscal exit strategies

## The excessive deficit procedure

- ✓ Deadlines and fiscal effort modulated in line with **fiscal space**
  - external imbalances, financial sector contingent liabilities, risk premia on sovereign debt and the projected increase in age-related expenditure also considered
  - debt given renewed focus
  
- ✓ Important **flanking policies** to the fiscal exit :
  - strengthened national budgetary framework
  - measures to support long-term sustainability.
  
- ✓ Forthcoming **SCPs** delayed to January 2010 to allow incorporation of EDP assessments
  - SCPs to contain a chapter dealing with the EDP recommendations
    - ✓ To include section on dealing with unsustainable debt levels and trend
    - ✓ To present budgetary measures and consolidation plans in a multi-annual framework
  - Specific consolidation measures to be updated in subsequent versions of SCPs
  - SCPs to give prominence to structural reforms with a direct bearing on fiscal outcomes and long-term sustainability
    - ✓ quality of public finances and fiscal governance changes relating to budgetary frameworks and measures to improve expenditure control to be flagged



# Exiting from the fiscal stimulus

## What do we know about how to consolidate successfully?

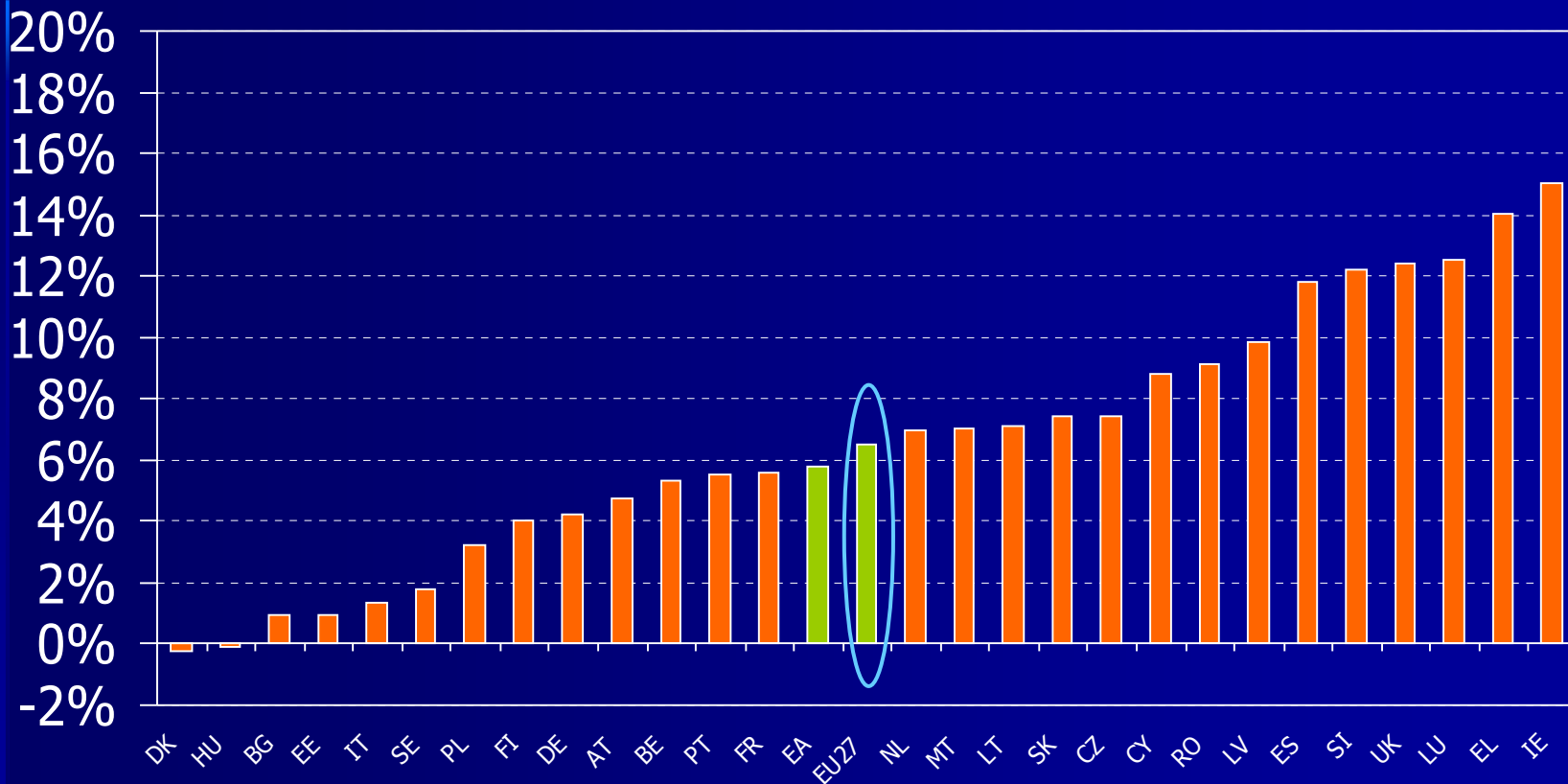
- ✓ Consolidations based on expenditure cuts tend to be longer lasting; however, given the extent of the imbalances, tax increases cannot be excluded
  - Expenditure based consolidation is more effective if also focuses on structural reforms increasing work incentives and public sector efficiency
  - Tax based consolidation tends to work better if it is gradual and starts from a lower level
- ✓ Gradual adjustments have proven more effective
  - Often accompanied by structural reforms
- ✓ Improvements in the fiscal institutions can be important complements to consolidation
  - Countries with existing strong institutions consolidate more effectively
- ✓ Difficult macroeconomic and public finance starting points can be catalysts for successful consolidations





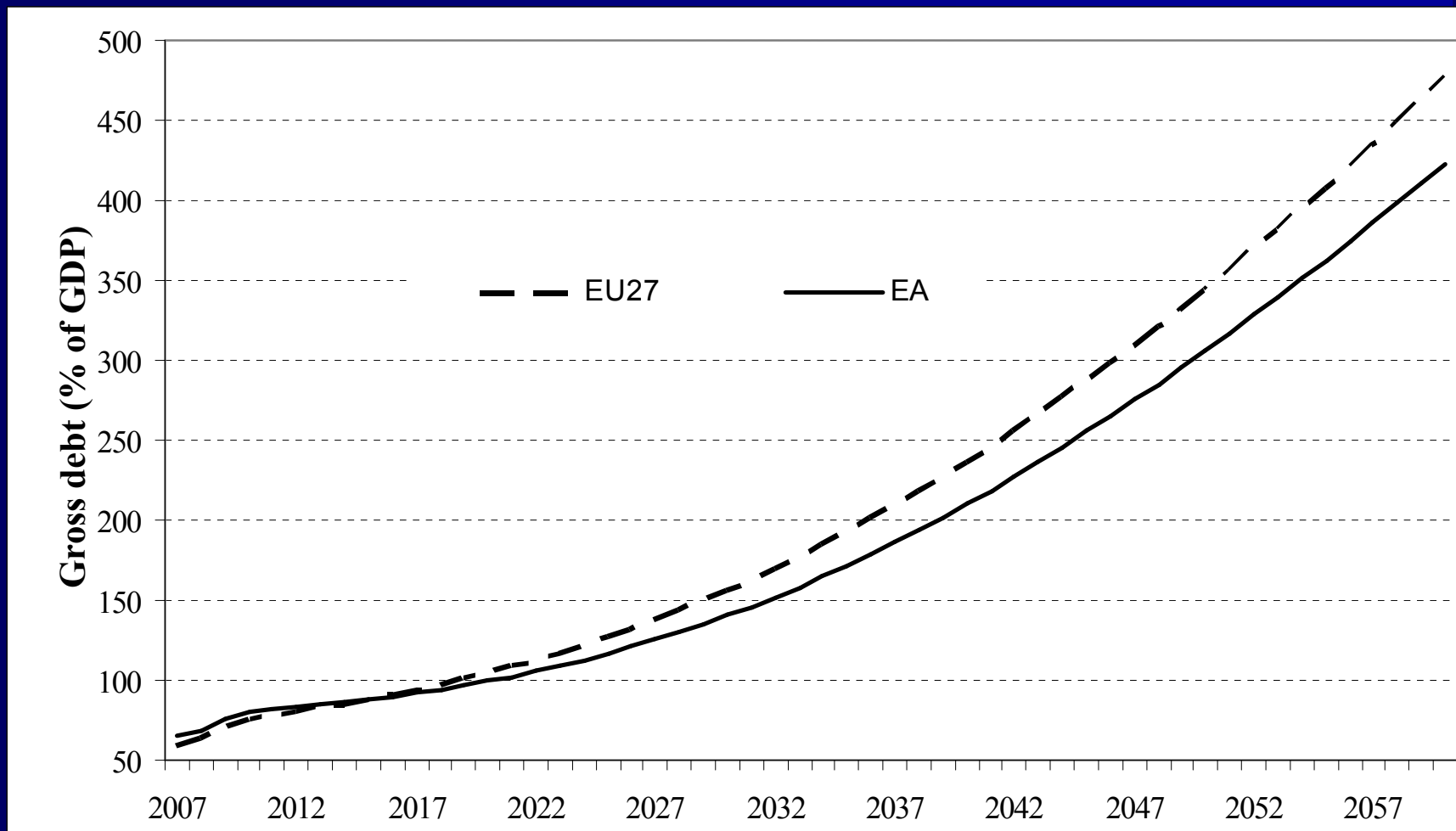
# The long term: the ageing challenge

## Sustainability gaps (in percent of GDP)



# The long term: the ageing challenge

## Government debt if no measures are taken





# Fiscal consolidation and ageing

## How to reduce the cost of ageing over time

- ✓ Stockholm strategy from the 2001 European Council
- ✓ Reduce debt to allow pre-financing
  - Would need to be in addition to reversing debt increases due to crisis
  - Could only be achieved very gradually
  - Might add to global imbalances
- ✓ Increase employment rates and productivity
  - Can accompany fiscal consolidation
  - May not reduce the cost of ageing much due to accrual of pension rights
- ✓ Reform pension, healthcare and long-term care systems
  - Shifting to private provision also has risks
  - Adequacy of provision must be ensured to make any changes effective
  - Raising retirement ages should be considered seriously, linking retirement age to life expectancy



# Conclusion

- ✓ Fiscal policy has played a central role in stemming the crisis, but the legacy is a marked deterioration in public finances
- ✓ Over the medium term, serious consolidation is needed to keep debt under control
- ✓ The crisis is not the only threat – ageing populations to have serious medium term consequences
- ✓ Implementation of exit needs careful preparation
- ✓ The nature of the consolidation affects the economy
- ✓ Provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, consolidation should begin in 2011 at the latest, with different intensities being appropriate for different countries
- ✓ The implementation of the Stability and Growth Pact to provide guidelines on the appropriate timing, size and composition of fiscal adjustment



DG ECFIN

**Thank you**